

Agricultural Lending

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

Note: FDIC Examiners should reference FIL-61-96, Analysis and Classification of Agricultural Credits, for general policy direction on analyzing and classifying agricultural credits.

POLICY CONSIDERATIONS

- 1 Determine if policies are appropriate for the bank's agricultural lending activities.
 - 1 A Ascertain whether policies address agricultural loan structuring.
 - 1 B Determine if the policy addresses and identifies potential environmental concerns (FIL 14-93).
 - 1 C Determine if collateral margins are established for specific types of agricultural lending.
 - 1 C1 1. Crops.
 2. Cattle (herd, feeder, backgrounding, or dairy operations).
 3. Swine (farrowing or finishing operations).
 4. Poultry.
 5. Exotic animals.
 6. Other agricultural products.
 7. Machinery and equipment.
 8. Real estate.
 - 1 D Evaluate documentation and minimum appraisal requirements.
 - 1 E Determine if the policy establishes guidance for monitoring hedging strategies, forward contracting, third party contracts, and timing of cash market sales.
 - 1 F Determine if the policy establishes restrictions on split-line financing.
 - 1 G Determine if thresholds for agricultural concentrations are established.

LOAN ADMINISTRATION

- 2 Review the bank's standard agricultural loan agreements.
- 3 Determine if management adequately evaluates the management ability of agricultural producers. (Poor farming practices or injury of key management can jeopardize collateral values. Farmers frequently do not participate in the workmen compensation program and are not eligible for unemployment insurance.)
- 4 Evaluate management's familiarity with changes in government subsidy programs, production advances, environmental regulations, and tax laws. (Farm subsidies can represent a significant proportion of producer income.)
- 5 Determine if management is familiar with bankruptcy provisions for agricultural operators under Chapter 12 of the U.S. Bankruptcy Code. (The chapter provides for reorganization of debtor

financial positions. Provisions can result in extended resolution periods, which are more debtor friendly than other bankruptcy relief.)

6 Review controls established to ensure that loan disbursements are monitored and documented. (Advances are typically supported by receipts or bills of sale.)

7 Assess the effectiveness of agricultural loan structuring. Consider the following items:

7 A Loan purpose. (Note: Loans for agricultural crop land are generally amortized over a period of 20 to 30 years. Major real estate improvements, such as livestock-confinement buildings and grain handling facilities, generally have amortization periods of less than 10 years. Loans to finance equipment are generally amortized from 3 to 5 years.)

7 B The growing season of crops, useful life of equipment, or type of livestock operation. (Maturity of loans should correspond to the timing of crop or auction revenues.)

7 C Carryover operating debt amortization.

7 D Amortization of capital improvements that derive value from longer term production contracts. (Failure to properly amortize capital improvements can result in erosion of collateral protection.)

7 E Split-line borrowing arrangements.

7 F Land payments. (Payments should be scheduled after calves or crops are sold.)

8 Determine if any of the following credit enhancements are used to support loans:

8 A Personal guarantees.

8 B Farm Service Agency programs.

8 C Small Business Administration programs.

8 D State-level programs including guarantees, deposit-link arrangements, interest rate buy-downs, and specialized tax incentives.

9 Determine whether management manages collateral margins through the following activities:

9 A Annual on-site inspection of capital assets, machinery, and equipment.

9 B Physical inspection of livestock collateral. (Frequency is dependent upon the type of livestock financed, but should be performed at least annually.)

9 C Use of feed on hand and equipment as additional equity.

9 D The monitoring of culling practices. (Failure to replace lesser quality or aging animals can impair collateral coverage.)

9 E Periodic valuation of feed and grain collateral. (Valuation can be based on the local cash price or the value of the hedged positions or forward contracts.)

9 F Periodic valuation of farm machinery and equipment. (Values can be derived with the assistance of knowledgeable third parties, published price guides, and auction reviews.)

9 G Periodic valuation of livestock collateral. (Valuation can be based on auction results published in local newspapers, the Wall Street Journal, forward contract amounts or hedging targets, and Farm Services Agency guide information.)

9 H Periodic valuation of registered livestock collateral. (Although there is a higher market value for these animals, marketability is limited. Sale catalogs, production contracts, or insurance values can provide reference information.)

9 I Periodic valuation of exotic animal and specialty crop collateral.

10 Evaluate management's review of and response to changing agricultural market conditions. (Weather conditions and commodity prices can impact production levels and collateral values.)

CREDIT ANALYSIS

General

11 Evaluate management's financial analysis of agricultural borrowers. The following items are common to agricultural credit analysis:

11 A Borrower information often is limited to tax returns, which are prepared on a cash basis.

11 B Agricultural balance sheets typically value machinery and equipment at estimated market value.

11 C Partial real estate and equipment ownership interests are common, and related debt should be identified.

11 D Collateral values should be frequently adjusted to reflect current market conditions.

11 E Borrower values for growing crops are frequently listed at input value.

11 F Hedging and off-balance sheet positions are common and may not be reflected in financial statements.

11 G Storage and transportation costs can be substantial and can significantly impact net income.

12 Determine whether agricultural loans are supported with appropriate cash flow projections.

12 A Product price assumptions must be validated.

12 B Yield assumptions must be verified.

12 C Operating expense projections should be compared to historical average.

13 Determine if cash flow assumptions encompass the borrower's entire operation (including multiple ventures), family living expenses, and reasonable capital expenditures.

DETERMINE IF MANAGEMENT IS COGNIZANT OF THE CASH FLOW CHARACTERISTICS OF VARIOUS TYPES OF AGRICULTURAL LENDING.

14 Grain Operators

14 A Revenues are generally recognized at harvest.

14 B Yield information is supported by historical production data.

14 C Price estimates can be supported by hedged positions, forward contracting prices, the local cash price, or Farm Services Agency prices.

14 D Operating expenses can be reviewed for consistency with historic performance and recognition of current costs.

14 E Cash flow can be affected by government price stabilization.

15 Cow/calf operations

15 A Income is normally recognized in the spring and fall after the sale of calves.

15 B Registered herd production will usually command higher prices since animals are sold for breeding purposes rather than slaughter.

15 C Production information should consider historical conception rates and death rates.

15 D Price projections can be supported by local cash market prices or Farm Service Agency price estimates.

15 E Projected feed costs are closely related to pasture conditions and availability.

15 F The severity of weather conditions can substantially affect the production and quality of calves.

16 Cattle Backgrounding Operations

16 A Revenue is generally recognized in the spring or fall as calves are raised to feeder weights.

16 B Revenues can be derived from sale of owned cattle or from payment for contract backgrounding services.

16 C Revenue projections will be primarily influenced by anticipated daily weight gain and projected sale price.

16 D Cash flow data should be supported by historical weight gains.

16 E Estimated pricing can be supported by local cash prices or futures markets.

17 Feeder Cattle or Fat Hog Operations

17 A Revenues are recognized as individual pens or herds of livestock are sold.

17 B Livestock loans should be supported by a pen-specific or herd-specific break-even analysis reflecting daily feed conversion factors and a hedged or forward contracted price.

18 Contract Livestock and Poultry Operations

18 A Revenues are generally recognized at least monthly.

18 B Contracts are usually long-term and specify inputs and production practices.

18 C Contractors provide animals and feed. Expenses are primarily capital, utilities, and labor costs.

18 D Producers are paid specific prices for production, including significant incentive bonuses.

19 Dairy Operation

19 A Milk revenue is generally received twice per month. Secondary income will be received from semi-annual sale of calves.

19 B Primary expense considerations are feed costs and capital expenditures.

19 C Production is generally well-documented by the operator.

19 D Price is established by cooperatives and is heavily influenced by government programs.

20 Vegetables and Specialized Crops

20 A Crops, including confectionery seeds, nut products, and fruits, are usually produced on a contract basis or marketed through cooperatives.

20 B Production levels are generally well-established.

20 C Prices are established under contract but can fluctuate widely over several growing seasons.

DOCUMENTATION

General

21 Determine if credit file documentation is adequate to legally identify collateral (serial numbers, model numbers, grain volume and location, etc.).

22 Ascertain if appropriate lien instruments are executed and perfected.

22 A A properly executed security agreement should be on file.

22 B A UCC-1 for most non-titled farm assets is filed at the county and state of domicile and operation. Extension must be filed within five years of original filing date.

22 C A UCC-1 for growing crops must identify specific crop locations and is filed annually.

22 D UCC-1 filings for livestock should include provisions for offspring and future acquisitions.

22 E Food Security Act of 1985 Lien Notification should be sent to potential purchasers of collateral assets.

22 F Assignments of milk production checks, U.S. government payments, livestock production contract payments, brokerage accounts, and life insurance policies should be recorded.

23 Review real estate appraisals or evaluations to determine if they identify the following items:

23 A Soil types.

23 B Topography.

23 C Rainfall and water table data.

23 D Crop production information.

23 E Capitalization rate. (Capitalization rates often range from 3 to 6 percent.)